COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

EAST KENTUCKY POWER COOPERATIVE, INC.'S FILING OF A PROPOSED CONTRACT WITH GALLATIN STEEL COMPANY	)))	CASE NO. 94-456

O R D E R

On November 2, 1994, East Kentucky Power Cooperative, Inc. ("East Kentucky") filed a proposed contract ("Contract") for the supply of electric service through Owen Electric Cooperative ("Owen") to Gallatin Steel Company ("Gallatin"). Upon review of the contract, the Commission determined that further investigation would be necessary and suspended its implementation through May 1, 1995. By Order dated March 9, 1995, the Commission approved, on an interim basis, Amendment No. 2 to the Contract which permitted East Kentucky, through Owen, to begin providing electric service to Gallatin for full scale testing of its facilities.[1]

The Contract, which has an initial term of ten years, sets forth the rates and conditions of service under which East Kentucky, through Owen, will provide firm and interruptible power to Gallatin for operation of its thin-slab steel mill near Ghent,

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[1] For start-up testing and for service provided during the construction of its facilities, Gallatin was served under Owen's Schedule 2 - Large Power Tariff. Amendment No. 2 to the Contract provided a means for East Kentucky to recover transmission charges imposed by Kentucky Utilities Company for 345 kv transmission service necessary to supply Gallatin during full-scale testing of its facilities. Amendment No. 1 to the Contract corrected a typographical error.

Kentucky, which resides in Owen's service territory. Gallatin expects to commence operation in two phases, with Phase I consisting of a single electric arc furnace, caster, and a five stand rolling mill. If it occurs, Phase II will include a second electric arc furnace and caster with the rolling mill increased to six stands. The Contract is the result of the combined efforts of East Kentucky, Louisville Gas and Electric Company ("LG&E"), and Kentucky Utilities Company ("KU") to provide service to Gallatin.[2]

The Commission required supporting information from East Kentucky regarding the terms of the Contract in its Orders dated December 22, 1994 and February 14, 1995. East Kentucky's responses have been submitted and the matter is before the Commission for final decision.

SUMMARY OF THE CONTRACT

10,000 kw of Gallatin's demand will be designated as firm power demand during Phase I with this amount increasing to 15,000 kw if Gallatin commences a Phase II operation. All demand exceeding firm power demand will be designated as interruptible demand, up to 120,000 kw total demand in Phase I and 210,000 total demand in Phase II. East Kentucky will supply all the power to serve Gallatin's firm power demand and approximately 50 percent of the power necessary to meet Gallatin's interruptible demand, with

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[2] LG&E will generate a portion of the power supplied to Gallatin and KU will provide transmission services to deliver a portion of the power necessary to meet Gallatin's power requirements.

LG&E supplying the remainder of the interruptible demand.[3] Gallatin's interruptible demand will consist of two categories: service subject to interruption on ten minutes' notice and service subject to interruption on ninety minutes' notice. In any calendar year interruptions by East Kentucky will not exceed 400 hours while LG&E's interruptions will not exceed 500 hours. The Contract includes a buy-through provision for LG&E interruptions.

The Contract sets forth demand charges for its full ten-year term for the three types of service: firm power demand; ten minute interruptible demand; and ninety minute interruptible demand, with different charges for power provided by East Kentucky and LG&E. The Contract sets forth energy charges for firm service, for East Kentucky-supplied interruptible service, and for LG&E-supplied interruptible service. For interruptible service, East Kentucky will recover its out-of-pocket energy costs, determined after-the-fact, based on system production cost modeling both "with and without" the Gallatin interruptible load.[4] The Contract provides for energy adders charged by East Kentucky for the energy it supplies and the energy supplied by LG&E. It sets forth the distribution charges to be applied by Owen to both the power and

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[3] LG&E will supply up to 50,000 kw during Phase I and another 50,000 kw if Gallatin commences a Phase II operation. The terms of LG&E's service are included in an agreement between East Kentucky and LG&E filed as Appendix I to the Contract.

[4] This costing approach has resulted in East Kentucky requesting a modification to its determination of fuel costs as used to calculate its fuel adjustment clause factor filed monthly with the Commission pursuant to 807 KAR 5:056.

energy delivered to Gallatin. In addition, it sets forth a monthly facilities charge of $47,000 to be paid by Gallatin to cover East Kentucky's actual investment in facilities installed to serve the Gallatin load.

DISCUSSION

East Kentucky has provided support and explanation for various aspects of the Contract which had been questioned by the Commission. The following discussion covers several of the substantive issues addressed by East Kentucky in those responses.

Rate Design

East Kentucky showed that the rates included in the Contract for firm service are based on its Section A tariff while the rates for interruptible service are derived from its Section C tariff, with the demand rates discounted to reflect the marginal capacity cost avoided due to Gallatin's load being subject to interruption. East Kentucky also demonstrated that the incremental energy costs incurred to serve Gallatin's interruptible load, based on its economic dispatch, will be greater than the system average fuel costs charged to its firm service customers.

East Kentucky, with input from Gallatin, also addressed the Commission's concern that Gallatin's kw demand was being averaged over a sixty minute period rather than a fifteen period as is typical for most industrial customers. East Kentucky explained that sixty minutes is commonly employed in averaging demand for steel mini-mills and that use of a sixty minute measurement was but one component of the total rate package negotiated by the parties.

Contract Termination

East Kentucky addressed the issue of possible termination of the Contract by Gallatin prior to East Kentucky's recovery of its investment in facilities constructed specifically to serve Gallatin. East Kentucky explained that the Facilities Charge, designed to recover those costs, is included in the minimum monthly bill which Gallatin is required to pay and that, in the event Gallatin discontinues service prior to the Contract's termination date, Gallatin is required to pay, as part of its final bill, the minimum bill for the balance of the full term of the Contract.

Fuel Adjustment Clause Reporting

In response to our February 14, 1995 Order East Kentucky identified proposed changes to its calculation of fuel cost to determine its monthly fuel adjustment clause ("FAC") factor.[5] East Kentucky indicated that these changes were needed to exclude from the FAC calculation the fuel cost it incurs to serve Gallatin and that it was appropriate to exclude this cost since it will be the actual, incremental cost to serve Gallatin's interruptible load, not the system average fuel cost, and therefore, should not be

[5] On February 24, 1995, East Kentucky filed a letter requesting Commission approval to modify its monthly FAC report to eliminate fuel and sales data related to the Gallatin Steel load. The Commission treated that request as a motion in Case No. 94-459, An Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of East Kentucky Power Cooperative, Inc. from November 1, 1992 to October 31, 1994. Interim approval was granted in that case by the Commission's Order dated April 5, 1995.

subject to an FAC adjustment. East Kentucky indicated it could provide a schedule, based on modeling its production cost both with and without the Gallatin interruptible load, as a supplement to its monthly FAC report, to better enable the Commission to monitor the costs and revenues associated with Gallatin.[6]

Future Rate Adjustments

Of particular concern to the Commission were the scheduled increases in East Kentucky's demand charges to Gallatin over the ten-year term of the Contract. East Kentucky explained that the scheduled increases, 12.4 percent and 8.8 percent in the years 1998 and 2001, respectively, were based on its 20-year financial forecast in effect at the time it was involved in negotiations with Gallatin.[7]

The Contract provides for future increases in East Kentucky's energy adders equal to the average percentage increases in its base rate revenues approved in subsequent cases before the Commission.[8] It is silent, however, on the issue of potential increases in environmental compliance costs that East Kentucky might seek to

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[6] See East Kentucky's Response to Item No. 5 of the Order dated February 14, 1995. The schedule will be prepared in the same general format as was included in East Kentucky's Response to Item No. 3 of the Order dated December 22, 1994.

[7] East Kentucky's Twenty-Year Financial Forecast - Equity Development Plan dated November 1992 was filed in response to Item No. 2 of the Commission's Order dated February 14, 1995.

[8] The Contract includes a similar provision for the energy charge component of Owen's distribution charges to Gallatin.

recover in the future via an "environmental surcharge" filing pursuant to KRS 278.183. The Commission considers this an open issue that will be addressed, if and when, East Kentucky makes an application under that statute.

SUMMARY

After considering the Contract and East Kentucky's responses to the data requests, and being sufficiently advised, the Commission finds that:

1. East Kentucky's service to Gallatin is primarily interruptible in nature and East Kentucky's tariffs, at the time the Contract was negotiated, did not include any provision for interruptible service; therefore, establishing terms for service to Gallatin by special contract is reasonable under the circumstances.

2. The Contract's terms for providing service to Gallatin adequately balance the interests of East Kentucky, Gallatin and Owen and will not subject other customers on the East Kentucky system to any unreasonable prejudice or disadvantage.

3. East Kentucky shall modify its monthly fuel adjustment clause report in the manner requested and file with said report a monthly schedule, as described herein, to assist the Commission in monitoring the revenues and costs associated with serving Gallatin.

4. In total, as a rate and service package, the Contract between East Kentucky and Gallatin, as amended, is reasonable and should be approved.

5. The issue of whether this Contract should be revised to reflect environmental costs which East Kentucky seeks to recover from its customers pursuant to an application filed under KRS 278.183 will be addressed at such time as East Kentucky files such an application.

IT IS THEREFORE ORDERED that the Contract for electric service between East Kentucky, Owen and Gallatin, as amended, be and it hereby is approved effective with the date of this Order.

Done at Frankfort, Kentucky, this 14th day of April, 1995.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director